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IN THE

Supreme Court of the United States

TELLABS, INCORPORATED AND RICHARD C. NOTEBAERT,
Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR AMICI CURIAE JOSEPH A. GRUNDFEST, ARTHUR ROCK, GENENTECH, INC., INTEL CORP., THE NASDAQ STOCK MARKET, INC., NETFLIX, INC., AND SYNOPSYS, INC. IN SUPPORT OF PETITIONERS

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INTERESTS OF AMICI[1]

Joseph A. Grundfest is the William A. Franke Professor of Law and Business at Stanford Law School, Co-Director of the Rock Center on Corporate Governance at Stanford University, and a former Commissioner of the United States Securities and Exchange Commission. Professor Grundfest's scholarship addresses the interpretation of the "strong

[1] No counsel for a party authored this brief in whole or in part, and no persons or entities, other than amici, their members, or their counsel, made a monetary contribution to the preparation or submission of this brief. Letters from the parties consenting to the filing of this brief are on file with the Clerk.

inference" standard,[2] the implied nature of the private right of action that arises under Section 10(b),[3] and the economic forces that create significant settlement leverage in high variance litigation.[4] Professor Grundfest is also a director and co-founder of Financial Engines, Inc., the parent of a federally registered investment adviser, which as of January 31, 2007, had more than $8.3 billion in assets under management. In the event that Financial Engines were to engage in a public offering of its shares, its officers and directors would become subject to the PSLRA's strong inference pleading standard.

Arthur Rock has been described as one of the founding fathers of venture capital in the United States, and has been credited with coining the term "venture capital." Mr. Rock and his firms have provided early stage financing to Intel, Apple Computer, Teledyne, Scientific Data Systems, General Transistor, and Diasonics, as well as to dozens of other technology firms.

Genentech, Inc. is a leading biotechnology company that discovers, develops, manufactures, and commercializes biotherapeutics for significant unmet medical needs. Genentech had a market capitalization of approximately $91 billion as of January 31, 2007.

Intel Corp. is the world's largest semiconductor chip maker. Intel develops advanced integrated digital technology platforms for the computing and communications industries. Intel's market capitalization as of January 31, 2007, was approximately $121 billion.

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[2] Grundfest & Pritchard, *Statutes With Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 Stan. L. Rev. 627 (2002).

[3] Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 Harv. L. Rev. 961 (1994); Grundfest, *Why Disimply? Commentaries*, 108 Harv. L. Rev. 727 (1995).

[4] Grundfest & Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 Stan. L. Rev. 1267 (2006).

The NASDAQ Stock Market, Inc. (NASDAQ®) is the largest electronic screen-based equity securities market in the United States. With approximately 3,200 companies, it lists more companies and, on average, trades more shares per day than any other U.S. market. It is home to companies that are leaders across all areas of business including technology, retail, communications, financial services, transportation, media, and biotechnology. NASDAQ is the primary market for trading NASDAQ-listed stocks. NASDAQ is also itself a publicly traded entity and had a market capitalization of approximately $3.8 billion as of January 31, 2007.

Netflix, Inc. is the world's largest online movie rental service, providing more than five million subscribers access to over 70,000 DVD titles. Netflix had a market capitalization of approximately $1.5 billion as of January 31, 2007.

Synopsys, Inc. develops and distributes electronic design automation software and related services for semiconductor design companies. Synopsys shares had a total market capitalization of approximately $3.8 billion as of January 31, 2007.

As publicly traded firms, Genentech, Intel, NASDAQ, Netflix, and Synopsys are each potentially subject to implied private rights of action that would be governed by the PSLRA's strong inference pleading standard.

SUMMARY OF ARGUMENT

The pertinent requirement of the PSLRA—that a private complaint under Rule 10b-5 must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind"—imposes a high standard for pleading scienter. Three circumstances individually and collectively require a strict reading of the PSLRA.

First, the private cause of action was "implied" (judicially created), by a procedure this Court would no longer endorse, and the courts therefore have had to perform the essentially legislative task of defining the elements and boundaries of the cause of action. This circumstance alone

suggests that the cause of action should be narrowly construed on any point where its scope is otherwise in doubt, rather than allow the judicially created cause of action to enlarge through judicial interpretation that, by definition, cannot be rooted in congressional direction.

Second, the Court has repeatedly recognized that the private cause of action poses a special "danger of vexatiousness" and has interpreted it narrowly to combat that danger. The requirement of proof of " 'scienter'—intent to deceive, manipulate, or defraud" is one of the several important barriers this Court has erected against that danger. The scienter requirement operates effectively as a barrier against vexatious litigation only if it is significant at the pleading stage.

Third, Congress recognized in the PSLRA precisely the dangers that this Court had long seen in the Rule 10b-5 cause of action, and it enacted the "particularity" and "strong inference" requirements for the purpose of combating them. The Court recognized this congressional purpose last Term in *Merrill Lynch, Pierce, Fenner & Smith* v. *Dabit*, 126 S. Ct. 1503, 1510 (2006), and the purpose is plain from the text of the PSLRA provision and the circumstances of its enactment, regardless of the competing phrases injected into the formal legislative history by Members of Congress with varying individual points of view.

A "strong inference" from particular alleged facts means an inference that emerges, after comparison with possible competing inferences, as significantly or substantially more likely than not to be true. An "inference" is a " 'conclusion reached by considering other facts and deducing a logical consequence from them.' " *Johnson* v. *California*, 545 U.S. 162, 168 n.4 (2005) (quoting Black's Law Dictionary 781 (7th ed. 1999)). The word may sometimes be used more casually, but the Court properly assumes that Congress uses such a word in its formal sense, and the statutory requirement of a "strong" inference removes any doubt.

Alleged facts cannot give rise to a strong inference of scienter if they equally imply other possibilities inconsistent

with such intent. The court of appeals therefore committed a serious error when it declined to consider alternative "innocent" inferences. Scienter cannot be a "strong" logical deduction from alleged facts unless it is significantly or substantially more likely than not to be true, and a court cannot make that determination if it ignores other possibilities.

The court of appeals also erred in concluding that it should give a softer and nonliteral reading to "strong inference" in order to avoid a potential issue under the Seventh Amendment. The PSLRA does not, on any interpretation of the clause at issue, take any factual determination away from the jury and give it to the judge. The statute simply defines one pleading requirement for a federal cause of action, something Congress is entirely free to do without impinging on the Seventh Amendment, as other pleading requirements and procedural barriers to getting a case to the jury make clear.

ARGUMENT

I. THE HISTORY OF THE RULE 10b-5 CAUSE OF ACTION STRONGLY REINFORCES PETITIONERS' ARGUMENT THAT THE "PARTICULARITY" AND "STRONG INFERENCE" REQUIREMENTS OF THE PSLRA EMBODY A HIGH STANDARD FOR PLEADING SCIENTER

Section 21D of the Securities Exchange Act of 1934 ("1934 Act"), which was added by the Private Securities Litigation Reform Act ("PSLRA"), requires the plaintiff, in a private action under the 1934 Act, to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). The court "shall . . . dismiss the complaint" if that pleading requirement is not met. *Id.* § 78u-4(b)(3)(A). In the case of a Rule 10b-5 cause of action, the required state of mind is " 'scienter'—intent to deceive, manipulate, or defraud." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 193 (1976).[5] Nevertheless, the court of appeals in this case ruled

[5] We note that this Court has reserved its view on whether scienter includes recklessness; all courts of appeals that have considered the ques-

that a private Rule 10b-5 complaint will survive dismissal "if it alleges facts from which, if true, a reasonable person *could* infer that the defendant acted with the required intent." Pet. App. 20a (emphasis added). This hardly differs from the pre-PSLRA pleading standard. *See Swierkiewicz* v. *Sorema N.A.*, 534 U.S. 506, 514 (2002) ("Given the Federal Rules' simplified standard for pleading, [a] court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." (internal quotation marks and citation omitted; alteration in original)); *cf. Patton* v. *Przybylski*, 822 F.2d 697, 700 (7th Cir. 1987) (affirming dismissal under Federal Rule of Civil Procedure 12(b)(6) because "no reasonable finder of facts could, we think, infer that [the defendant] acted unreasonably").

The whole history of the Rule 10b-5 cause of action suggests that the court below erred and that the "particularity" and "strong inference" requirements should be understood to erect a high requirement for pleading scienter. Three points stand out in this respect. First, the Rule 10b-5 cause of action is a judicial creation, whose elements remain defined entirely by the courts. Second, in exercising its responsibility to define and limit the Rule 10b-5 cause of action, this Court has been vigilant to protect against abusive use of this judicial creation. Third, Congress, in enacting the PSLRA, acted against the background of this Court's cases embracing such vigilance, and acted out of similar concerns.

A. The Rule 10b-5 Cause Of Action Is A Judicial Creation

The courts created the private cause of action for violations of Rule 10b-5. Although this Court recognized in 1983

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tion have held that it does; and the circuits appear to be split on what constitutes recklessness for this purpose. *See* Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 Harv. L. Rev. 961, 1012 (1994). The PSLRA seems carefully to preserve this issue for this Court, by referring to "the required state of mind," 15 U.S.C. § 78u-4(b)(2).

that the existence of this implied cause of action was "simply beyond peradventure," *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 380 (1983), the Court has also repeatedly recognized, both before and since 1983, that "there is no indication that Congress, or the Commission, when adopting Rule 10b-5, contemplated such a remedy," *Hochfelder*, 425 U.S. at 196 (footnotes omitted); *see also Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 359 (1991) ("[W]e have made no pretense that it was Congress' design to provide the remedy afforded."). As the Court acknowledged only last Term, then-Justice Rehnquist in 1975 aptly "described the rules governing private Rule 10b-5 actions" as "the 'judicial oak which ha[d] grown from little more than a legislative acorn.'" *Merrill Lynch*, 126 S. Ct. at 1510 (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737 (1975)) (alteration in original).[6]

Indeed, if the Court's current view about finding implied private causes of action in federal statutes, *see, e.g.*, *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979), had been in place when the issue was first decided, it seems highly unlikely that the Court would have "confirmed with virtually no discussion . . . that such a cause of action did exist," *Blue Chip Stamps*, 421 U.S. at 730 (citing *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971); *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 150-154 (1972)). As Justice Scalia noted in *Holmes* v. *Securities Investor Protection Corp.*, 503 U.S. 258 (1992), "[T]he contours of a Rule 10b-5 action" were " 'implied' (*i.e.*, created) by the Court itself—a practice we have since happily abandoned[.]" *Id.* at 289 (Scalia, J., concurring in judgment) (citing *Touche Ross & Co.*, 442 U.S. at 568-571, 575-576). *See generally* Ruder, *Civil Liability Under Rule 10b-5: Judicial*

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[6] For an analysis of the history of the section 10(b) implied right of action, *see* Grundfest, *supra* n.5, at 985-998.

Revision of Legislative Intent?, 57 Nw. U. L. Rev. 627 (1963).[7]

The fact that the Rule 10b-5 cause of action is "of judicial creation," *Lampf*, 501 U.S. at 358, has meant that the courts have had the responsibility for defining its elements. As this Court has recognized, because "Congress did not create a private § 10(b) cause of action [it] had no occasion to provide guidance about the elements of a private liability scheme." *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994); *see also Musick, Peeler & Garrett* v. *Employers Ins. of Wausau*, 508 U.S. 286, 292 (1993) ("The federal courts have . . . exercised the principal responsibility for the continuing elaboration of the scope of the 10b-5 right and the definition of the duties it imposes."). As this Court has also recognized, the fact that the cause of action was judicially created, by a process this Court would not now endorse, provides a reason for choosing narrow rather than broad readings of the right. *See Blue Chip Stamps*, 421 U.S. at 748-749 ("We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or another unless and until Congress addresses the ques-

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[7] Since the 1970s, this Court has repeatedly cautioned "that private parties may employ . . . an implied private right of action only if they demonstrate an 'unambiguously conferred right.' " *Pharmaceutical Research & Mfrs. of Am.* v. *Walsh*, 538 U.S. 644, 683 (2003) (Thomas, J., concurring in judgment) (quoting *Gonzaga Univ.* v. *Doe*, 536 U.S. 273, 283 (2002)); *see Alexander* v. *Sandoval*, 532 U.S. 275, 286-287 (2001) (stating that without congressional "intent to create not just a private right but also a private remedy . . . a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute"); *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1102 (1991) ("[A]ny private right of action for violating a federal statute must ultimately rest on congressional intent to provide a private remedy." (citing *Touche Ross & Co.*, 442 U.S. at 575)); *California* v. *Sierra Club*, 451 U.S. 287, 297 (1981) ("The federal judiciary will not engraft a remedy on a statute, no matter how salutary, that Congress did not intend to provide."); *Touche Ross & Co.*, 442 U.S. at 575 ("The central inquiry [is] whether Congress intended to create, either expressly or by implication, a private cause of action.").

tion."); *cf. Gebser* v. *Lago Vista Indep. Sch. Dist.*, 524 U.S. 274, 284 (1998) ("Because the private right of action under Title IX is judicially implied, we have a measure of latitude to shape a sensible remedial scheme[.]").

B. This Court Has Been Vigilant To Protect Against Abusive Use Of This Judicially Created Cause Of Action

In exercising its responsibility to define the judicially created Rule 10b-5 cause of action, this Court has repeatedly emphasized the particular dangers this remedy poses, and has cabined the cause of action to protect against those dangers, proceeding both cautiously and out of deference to the proper role of Congress. Only four years after first recognizing the Rule 10b-5 cause of action in *Superintendent of Insurance*, 404 U.S. at 13 n.9, the Court took note of the "widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739. "[I]n this type of litigation, . . . the mere existence of an unresolved lawsuit has settlement value to the plaintiff not only because of the possibility that he may prevail on the merits, . . . but because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial[.]" *Id.* at 742-743.

It was "principally [such] 'policy considerations,'" "which the Court [in *Blue Chip Stamps*] viewed as appropriate in explicating a judicially crafted remedy," that underlay the decision "to limit the private remedy . . . by means of the purchaser-seller limitation." *Merrill Lynch*, 126 S. Ct. at 1510 (quoting *Blue Chip Stamps*, 421 U.S. at 737); *see also id.* (stating that the Court sought to "minimize the[] ill effects" that would be engendered by a broader cause of action); *Virginia Bankshares*, 501 U.S. at 1104-1105 ("Faced in [*Blue Chip Stamps*] with . . . rounding out the scope of an implied private statutory right of action, we

looked to policy reasons for deciding where the outer limits of the right should lie.").

These same concerns have consistently animated other decisions in which this Court has limited the Rule 10b-5 cause of action and other private causes of action under the 1934 Act. For example, in *Hochfelder*, in reaching the conclusion that no cause of action will lie under Rule 10b-5 unless there is an allegation of " 'scienter'—intent to deceive, manipulate, or defraud," 425 U.S. at 193, the Court "consider[ed] it significant that each of the express civil remedies in the 1933 Act allowing recovery for negligent conduct . . . is subject to significant procedural restrictions," *id.* at 209. Citing *Blue Chip Stamps*, 421 U.S. at 740-741, the Court noted that "Congress regarded these restrictions as significant" and that "[o]ne of [the] purposes" of such restrictions "was to deter actions brought solely for their potential settlement value." *Hochfelder*, 425 U.S. at 210 n.30. The Court thus recognized, as it had the Term before in *Blue Chip Stamps*, that barriers against vexatious litigation are generally only effective at the pleading stage because after this point "even a complaint which by objective standards may have little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial." 421 U.S. at 740; *see also id.* at 741 (expressing concern about the "potential for possible abuse of the liberal discovery provisions of the Federal Rules of Civil Procedure" in securities fraud cases).

More recently, in *Dura Pharmaceuticals Inc.* v. *Broudo*, 544 U.S. 336 (2005), the Court unanimously rejected an argument that a private plaintiff adequately alleges loss causation under Rule 10b-5 by alleging that the price of a security on the date of purchase was inflated, explaining, *inter alia*, that such an approach "would permit a plaintiff 'with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the discovery process

will reveal relevant evidence.'" *Id.* at 347 (quoting *Blue Chip Stamps*, 421 U.S. at 741) (alteration incorporated).

The Court sounded the same theme in *Virginia Bankshares*, 501 U.S. at 1104-1105, rejecting respondents' theory of causation there. The Court noted that "[t]his is not the first effort in recent years to expand the scope of an action originally inferred from the Act without conclusive guidance from Congress." It observed that "*Blue Chip Stamps* set an example worth recalling," and expressed concern about "the same threats of speculative claims." *Id.* (internal quotation marks and citation omitted). The Court made a similar point in *Central Bank of Denver*, 511 U.S. at 188-189, concluding that Rule 10b-5 does not provide a private cause of action against aiders and abettors. The Court repeated that "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general," and it expressed concern that such litigation "requires secondary actors to expend large sums even for pretrial defense and the negotiation of settlements." *Id.* at 189 (internal quotation marks and citations omitted).

The Court expressed comparable concerns in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), unanimously[8] rejecting the argument that a material fact is one "which a reasonable shareholder *might* consider important." *Id.* at 449 (emphasis in original). Such a standard, the Court explained, was "'too suggestive of mere possibility,'" *id.* (quoting *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1302 (2d Cir. 1973)), threatening to change management's behavior for the worse out of "fear of exposing itself to substantial liability" "for insignificant omissions or misstatements," *id.* at 448. The Court therefore held that a fact "is material [only] if there is a substantial likelihood that a rea-

[8] Justice Stevens took no part in the consideration or decision of the case. *Id.* at 464.

sonable shareholder *would* consider it important." *Id.* at 449 (emphasis added).[9]

C. In Enacting The PSLRA, Congress Acted Against The Background Of The Cases In Which This Court Expressed Concern About The "Danger Of Vexatiousness," And Congress Acted With Similar Concerns

Scholars have noted that the "formal" legislative history of the PSLRA is susceptible to multiple interpretations and that it contains conflicting remarks about congressional intentions, reflecting the hopes of different Senators and Representatives. *See, e.g.*, Grundfest & Pritchard, *Statutes With Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 Stan. L. Rev. 627, 655-660 (2002). But there is a less manipulable and surer guide to congressional intent and the proper interpretation of the PSLRA: the long history of the concerns this Court has expressed with regard to the private cause of action under Rule 10b-5, and Congress's clear recognition of the same concerns.

In the first place, when Congress legislates against the background of a well-established judicial interpretation of a statute, Congress is presumed to be aware of the interpretation and to assume it. *See, e.g., Commissioner* v. *Keystone Consol. Indus., Inc.*, 508 U.S. 152, 159 (1993) (stating "Congress presumptively was aware" of "settled judicial and

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[9] Two recent decisions in which the Court took an arguably more expansive approach are readily distinguishable, as both involved interpretation of the reach of section 10(b) rather than definition of the implied private right of action. *See SEC* v. *Zanford*, 535 U.S. 813, 819-820 (2002) (Court deferred to the SEC's interpretation in a formal adjudication of the phrase in section 10(b) "in connection with the purchase or sale of any security" (quoting 15 U.S.C. § 78j)); *Wharf Holdings, Ltd.* v. *United Int'l Holdings, Inc.*, 532 U.S. 588, 595 (2001) (Court rejected petitioner's principal contention that its conduct fell outside the scope of the statute because the agreement at issue was oral, stating that the Securities Exchange Act of 1934 "says that it applies to 'any contract' for the purchase or sale of a security" (citing 15 U.S.C. § 78c(a)(13))).

administrative interpretation [of relevant terms] over the course of a half century" in adopting a statute); *Lorillard* v. *Pons*, 434 U.S. 575, 581 (1978) ("[W]here . . . Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute."). The same should be true, *a fortiori*, where Congress legislates against the background of extensive case law dealing with a judicially created cause of action. "It is always appropriate to assume that our elected representatives, like other citizens, know the law." *Traynor* v. *Turnage*, 485 U.S. 535, 546 (1988) (internal quotation marks and citation omitted).

Moreover, in this instance there is ample evidence that Congress was in fact aware of the concerns this Court had expressed, and that it was motivated by the same concerns. This Court said last Term, "Policy considerations similar to those that supported the Court's decision in *Blue Chip Stamps* prompted Congress, in 1995, to adopt legislation targeted at perceived abuses of the class-action vehicle in litigation involving nationally traded securities." *Merrill Lynch*, 126 S. Ct. at 1510. The Court cited "the House Conference Report accompanying what would later be enacted as the [PSLRA]," *id.*, for the proposition that "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and 'manipulation by class action lawyers of the clients whom they purportedly represent' had become rampant in recent years," *id.* at 1510-1511 (quoting H.R. Rep. No. 104-369, at 31 (1995)). The Court has explained that, in an "effort to curb these perceived abuses," the PSLRA "imposes heightened pleading requirements in actions brought pursuant to § 10(b) and Rule 10b-5," *id.* at 1511, "insist[ing] that securities fraud complaints 'specify' each misleading statement . . . and that they 'state with particularly facts giving rise to a strong inference that the defendant acted with the required state of mind,'" *Dura Pharms.*, 544 U.S. at 345 (quoting 15 U.S.C. § 78u-4(b)(1), (2)).

It is critically important that Congress required plaintiffs to *plead* the required facts, and that it required them to plead such facts *with particularity*. If Congress had merely set a high scienter standard for the factfinder, but had allowed plaintiffs to follow the ordinary rules of notice pleading, it would not have dealt with the central problem, which is that in securities cases an undismissed complaint coupled with the ability to take discovery gives the plaintiff extraordinary leverage. As this Court said in *Blue Chip Stamps*, "even a complaint which by objective standards may have little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial," 421 U.S. at 740, in part because of the "potential for possible abuse of the liberal discovery provisions of the Federal Rules of Civil Procedure" in securities fraud cases, *id.* at 741. There is, particularly in large class actions, what Judge Friendly called the danger of "blackmail settlements." Henry J. Friendly, *Federal Jurisdiction: A General View* 120 (1973).[10] Nonmeritorious cases can be stopped at the threshold only if the plaintiffs are required not merely to provide strong *proof* of scienter but to plead it with particularity at the outset.[11]

Congress has carefully followed the courts' work and responded to it on other issues arising under Rule 10b-5. As the Court said in *Musick*, 508 U.S. at 293, the judiciary's "cumulative work in [the] design" of the Rule 10b-5 cause of action has been closely watched by Congress. After the Court "resol[ved] . . . a difficult statute of limitations issue for 10b-5 suits [in *Lampf*]," for example, "Congress inter-

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[10] For an analysis of some of the reasons why securities fraud class actions often create unjustified pressures to settle, see Grundfest & Huang, *supra* n.4.

[11] *Cf. In re Merrill Lynch & Co.*, 273 F. Supp. 2d 351, 370 (S.D.N.Y. 2003) ("These provisions mandate a school of realism, not impressionism. Plaintiffs must set forth *with particularity each* statement they assert was fraudulent and why, in their view, the statement was fraudulent—specifying who made it and where and when it was made." (emphasis in original)).

vened by limiting the retroactive effect of [the] decision." *Id.* (citing 15 U.S.C. § 78aa-1). Similarly, in the PSLRA itself, Congress clarified that the SEC could bring suit against aiders and abettors under section 10(b) in civil enforcement actions, *see* Pub. L. No. 104-67, 109 Stat. 737, 757 (1995) (codified at 15 U.S.C. § 78t(e)), an issue not resolved in *Central Bank of Denver*, *see* 511 U.S. at 199-200 (Stevens, J., dissenting). Given Congress's actions, and "the peculiar blend of legislative, administrative, and judicial history which ... surrounds Rule 10b-5," *Blue Chip Stamps*, 421 U.S. at 749, "it is not only appropriate but also realistic to presume that Congress was thoroughly familiar with the[] unusually important precedents from [this Court] and other federal courts and that it expected its enactment to be interpreted in conformity with them," *Cannon* v. *University of Chicago*, 441 U.S. 677, 699 (1979).

Scholars have recognized what Congress plainly did in enacting the PSLRA. "The [PSLRA] was clearly a product of th[e] sense that securities class actions were disproportionately nonmeritorious." Coffee, *Reforming The Securities Class Action: An Essay On Deterrence And Its Implementation*, 106 Colum. L. Rev. 1534, 1534 n.1 (2006).

> In enacting the PSLRA, Congress announced this view explicitly, stating in the legislative history that among the PSLRA's purposes was the desire to end the "routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action."

Id. (quoting H.R. Rep. No. 104-369, at 31 (1995)).

In sum, this Court should interpret the provisions of the PSLRA in a way that serves the end the Court has long articulated and that Congress plainly recognized in enacting the statute: stopping weak cases and fishing expeditions before discovery. The Court should rule, first, that the

statutory requirement that a complaint must state scienter "facts" "with particularity" means that the facts must be specific and genuinely factual, rather than conclusory. *See, e.g., Florida State Bd. of Admin.* v. *Green Tree Fin. Corp.*, 270 F.3d 645, 660 (8th Cir. 2001) ("[W]hereas under Rule 12(b)(6), we must assume all factual allegations in the complaint are true, . . . under the [PSLRA], we disregard 'catch-all' or 'blanket' assertions that do not live up to the particularity requirements of the statute."). The Court should rule, second, that to satisfy the "strong inference" requirement these allegations of particular facts must be sufficient to persuade the trial court that, if they are later proved true, the plaintiffs will have demonstrated intent to deceive, manipulate, or defraud, *see Hochfelder*, 425 U.S. at 193, 193 n.12. Amici take up the meaning of "strong inference" further below.

II. A "STRONG INFERENCE" FROM PARTICULAR ALLEGED FACTS MEANS AN INFERENCE THAT EMERGES, AFTER COMPARISON WITH POSSIBLE COMPETING INFERENCES, AS SIGNIFICANTLY OR SUBSTANTIALLY MORE LIKELY THAN NOT TO BE TRUE

English usage and logic confirm that the PSLRA's "strong inference" requirement sets a high hurdle for pleading a Rule 10b-5 cause of action. They suggest that an inference based on particular alleged facts can be "strong" only if it emerges, after comparison with competing inferences from the same facts, as significantly or substantially more likely than not to be true.

An "inference" is a " 'conclusion reached by considering other facts and deducing a logical consequence from them.' " *Johnson* v. *California*, 545 U.S. 162, 168 n.4 (2005) (quoting Black's Law Dictionary 781 (7th ed. 1999)); *see also NLRB* v. *Curtin Matheson Scientific, Inc.*, 494 U.S. 775, 814-815 (1990) (Scalia, J., dissenting) (defining "inference" as "[a] process of reasoning by which a fact or proposition sought to be established is deduced as a logical consequence from other facts, or a state of facts, already proved or admitted") (quoting Black's Law Dictionary 700 (5th ed. 1979)); American Heritage College Dictionary 710 (4th ed. 2002) (defining

"inference" as "[t]he act or process of deriving logical conclusions from premises known or assumed to be true"). As applied to the PSLRA provision in question, the definition means that scienter must logically follow from the facts pleaded "with particularity" in the complaint.

Congress deliberately added the word "strong."[12] "Strong" is a word of many meanings, but in this context the applicable definition is "urgent, compelling." Webster's Third New International Dictionary 2265 (2002). *See also Helwig* v. *Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001) ("defining 'strong' as 'cogent, powerful, forcible, forceful' ") (quoting Black's Law Dictionary 1423 (6th ed. 1990)); American Heritage College Dictionary 1346 (3d ed. 1997) ("[p]ersuasive, effective, and cogent"). Thus the inference, from the facts pleaded with particularity in the complaint, must be not only logical but "compelling," "persuasive, ... and cogent." The question for a district court is whether, assuming the truth of the particular facts pleaded, it follows compellingly, or in the alternative formulation persuasively and cogently, as a matter of logic and experience, that the defendants acted with the required intent to deceive.

A court cannot make that determination without considering, and rejecting as less persuasive and cogent, alternative hypotheses that involve no intent to deceive. *Cf.* John R. Platt, *Strong Inference*, 146 Sci. 347, 347 (1964) (in science, "[s]trong inference" consists of "[d]evising alternative hypotheses" and systematically excluding them by experiments). "Scienter" cannot be said to follow "persuasively and cogently" from pleaded facts if the same facts equally, or nearly equally, support an inference that there was no scienter. By requiring the district court to find that, assuming the pleaded particular facts, and after consideration of alternative hypotheses, the inference of scienter is significantly

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[12] "That the statute, by its terms, requires a 'strong,' rather than merely a 'reasonable,' inference that the defendant acted with scienter is more than an odd linguistic quirk." *In re Credit Suisse First Boston Corp.*, 431 F.3d 36, 48 (1st Cir. 2005).

or substantially more likely than the inference of no scienter, this Court can give independent substance to the statutory mandate that the inference of scienter be "strong" and not merely reasonable or credible.[13]

The facts in *Gompper* v. *VISX, Inc.*, 298 F.3d 893 (9th Cir. 2002), are illustrative. Plaintiffs there sued a corporation for securities fraud, alleging that the corporation knew that its core patents were invalid and hence that its revenue projections were false or misleading. The complaint alleged that the corporation was aggressively suing its competitors for patent infringement and that this aggressiveness justified an inference that the corporation knew its patents were invalid and was trying to intimidate its competitors through litigation. But the Ninth Circuit ruled that an equally plausible inference was that the corporation consistently asserted its patents in litigation because it believed the patents were valid and recognized that the patented technology was key to its business. "Consideration of this [competing] inference quite clearly impedes the plaintiffs' progress toward building the requisite strong inference of scienter." *Id.* at 897. The court could not assess the strength of the proffered inference without considering competing ones. To require a court to consider only inferences favorable to a plaintiff's position would be to "eviscerate the PSLRA's strong inference requirement by allowing plaintiffs to plead in a vacuum." *Id.* at 896. Whatever the precise formulation, the statutory requirement demands that a claim be dismissed unless the inference of scienter is significantly more likely than competing no-scienter inferences.

Because the "strong inference" standard requires consideration of all competing inferences from the facts pleaded,

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[13] The Court has found the words "significant" and "substantial" useful in defining the term "materiality" in securities law contexts. *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976) ("[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

lower court decisions suggesting that particular fact patterns (such as motive and opportunity) automatically establish a strong inference of scienter[14] are inconsistent with a proper reading of the Act. Nowhere does the statute say that motive and opportunity always suffice. Rather, in adopting the heightened pleading standard of the PSLRA, Congress was concerned with the quantum and particularity, not the category, of facts pleaded. *See, e.g., Helwig*, 251 F.3d at 551. A court must consider whether, of all the competing inferences from all of the facts pleaded, the inference of scienter is significantly the most likely.

III. THE PSLRA DOES NOT VIOLATE THE SEVENTH AMENDMENT

The Seventh Circuit based its erroneous reading of the "strong inference" requirement partly on a concern that a more stringent reading might violate the Seventh Amendment's civil jury trial guarantee. *See* Pet. App. 20a. That concern is unfounded.

The Seventh Amendment bars Congress from directing that a judge, rather than the jury, will decide any factual issue arising in a civil case to which it applies. The PSLRA does not do that. To the contrary, it specifies that the plaintiffs must *plead* certain kinds of facts in order to have a valid cause of action. Congress has ample power to control access to the lower federal courts, including the power to define what must be pleaded in order to state a federal case. *Compare* Fed. R. Civ. P. 9(b) (requiring that "the circumstances constituting fraud or mistake shall be stated with particularity"). Courts have not hesitated to dismiss complaints for failure to meet the "particularity" requirement of Rule

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[14] *E.g., Rombach* v. *Chang*, 355 F.3d 164, 176 (2d Cir. 2004) (to satisfy the strong inference requirement, " 'a complaint may . . . allege facts to show that defendants had both motive and opportunity to commit fraud' " (quoting *Rothman* v. *Gregor*, 220 F.3d 81, 90 (2d Cir. 2000))); *Kalnit* v. *Eichler*, 264 F.3d 131, 138-139 (2d Cir. 2001) ("the PSLRA did not change the basic pleading standard for scienter in this circuit"; therefore a plaintiff may demonstrate scienter "with motive and opportunity allegations" (internal quotation marks and citations omitted)).

9(b).[15] Indeed, Congress's power to impose heightened pleading requirements has never been questioned. *E.g.*, *Swierkiewicz*, 534 U.S. at 512-513; *Leatherman* v. *Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993). The Seventh Amendment "does not attempt to regulate matters of pleading or practice."[16]

There are numerous contexts in which judicial determinations can prevent claims from reaching juries, without violating the Seventh Amendment. These include summary judgment, *see* Fed. R. Civ. P. 56; 10A Wright, Miller & Kane, *Federal Practice and Procedure: Civil 3d* § 2714 (1998) ("[O]nce the court determines that there are no disputed material facts, it is free to enter a judgment on the basis of a determination of the governing legal issues and doing so does not deprive the opposing party of the right to a jury trial."); and judgment as a matter of law, *see* Fed. R. Civ. P. 50. *Cf. Dimick* v. *Schiedt*, 293 U.S. 474, 482-483 (1935) (remittitur is consistent with Seventh Amendment where prevailing party is offered the option of a new trial); *Daubert* v. *Merrell Dow Pharms., Inc.*, 509 U.S. 579, 590 (1993) (expert testimony can be excluded based on judicial determination of reliability).

When a court determines whether a complaint meets the applicable pleading requirements, it does not decide any fact issue. Rather, it determines whether plaintiffs have pleaded the required facts and thus are entitled to offer evidence to support their claims. *Cf. Scheuer* v. *Rhodes*, 416 U.S. 232, 236 (1974) ("The issue is not whether a plaintiff will

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[15] *See, e.g., Carroll* v. *Fort James Corp.*, 470 F.3d 1171 (5th Cir. 2006); *California Pub. Employees' Ret. Sys.* v. *Chubb Corp.*, 394 F.3d 126 (3d Cir. 2004); *In re Rockefeller Ctr. Props., Inc. Sec. Litig.*, 311 F.3d 198 (3d Cir. 2002).

[16] *Walker* v. *New Mexico*, 165 U.S. 593, 596 (1897) (dictum) (upholding procedural rule that allowed judge to enter judgment based on jury's answers to special interrogatories if inconsistent with general verdict); *see also Baltimore & Carolina Line, Inc.* v. *Redman*, 295 U.S. 654, 657 (1935) (Seventh Amendment is not implicated where mere matters of procedure and issues of law are concerned).

ultimately prevail but whether claimant is entitled to offer evidence to support the claims."), *overruled on other grounds*, *Harlow* v. *Fitzgerald*, 457 U.S. 800 (1982). If the applicable pleading requirements are not met, the complaint is properly dismissed for failure of pleading. In that situation, the court has not decided any factual issue, and there are no facts to be tried by the jury; thus, the right to a jury trial is not implicated. *See Smith* v. *Kitchen*, 156 F.3d 1025, 1029 (10th Cir. 1998) (dismissal of complaint did not implicate Seventh Amendment because plaintiff failed to plead any facts that would overcome defendants' defenses, so there were no facts to be tried by a jury); *Raul* v. *American Stock Exch.*, Nos. 95 Civ. 3154 (SAS), 95 Civ. 8361 (SAS), 1996 WL 627574, at *2 (S.D.N.Y. Oct. 29, 1996) (dismissal of complaint did not violate Seventh Amendment because plaintiff failed to state an actionable claim and thus "never fell within the aegis of the Seventh Amendment, and was never entitled to a jury trial"). The Seventh Amendment is simply irrelevant to the interpretation of the "strong inference" requirement in the PSLRA.

CONCLUSION

For these reasons, the decision below should be reversed.

Respectfully submitted,

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